

**DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS: 05-0411
GROSS RETAIL TAX
For the Years 1999, 2000, 2001, and 2002**

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Software Finance Charges – Sales / Use Tax.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-8.1-5-1(b).

Taxpayer argues that a portion of the price it paid for the purchase of computer software and the lease of computer hardware should be exempted from sales/use tax.

II. Environmental Quality Control Equipment – Sales / Use Tax.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-8.1-5-1(b); 45 IAC 2.2-5-70; 45 IAC 2.2-5-70(a).

Taxpayer argues that certain items of equipment are not subject to the state gross retail (Sales / Use) tax because the items were purchased for the purpose of complying with state, local, or federal environmental quality standards.

III. Production Equipment – Sales / Use Tax.

Authority: IC § 6-2.5-5-3(b); IC § 6-2.5-5-5.1(b).

Taxpayer argues that certain items it purchased are exempt from Sales / Use Tax because the items are directly used in the direct production of its manufactured products.

IV. Transporting Work-in-Process – Sales / Use Tax.

Authority: 45 IAC 2.2-5-8(f).

Taxpayer states that certain equipment is exempt from the Sales / Use Tax because the equipment is used to transport “work-in-process.”

V. Labels and Packaging Materials – Sales / Use Tax.

Authority: 45 IAC 2.2-5-15; 45 IAC 2.2-5-16; 45 IAC 2.2-5-16(a).

Taxpayer argues that purchases of labels are exempt from Sales / Use Tax.

VI. Waste Management Agreements – Sales / Use Tax.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-1-2; IC § 6-2.5-5-3(b); 45 IAC 2.2-4-1.

Taxpayer states that certain maintenance contracts are exempt because the agreements are for the provision of services.

VII. Packaging Header Cards – Sales / Use Tax.

Authority: 45 IAC 2.2-5-16(a).

Taxpayer argues that purchases of “header cards” are exempt because the cards are exempt packaging.

VIII. Safety Contract – Sales / Use Tax.

Authority: IC § 6-8.1-5-1(b).

Taxpayer maintains that contracts for consulting services are exempt.

IX. Purchase for Resale – Sales / Use Tax.

Authority: IC § 6-2.5-5-8(b); IC 6-8.1-5-4(a).

Taxpayer states that a certain portion of its purchases are exempt because the items bought were later resold.

STATEMENT OF FACTS

Taxpayer is an Indiana manufacturing business which constructs musical instruments. Taxpayer conducts business in multiple states. The Indiana Department of Revenue (Department) conducted an audit review of taxpayer’s records. Taxpayer disagreed with certain conclusions and submitted a protest. The matter was assigned to a hearing officer, and an administrative hearing was conducted during which taxpayer’s representative explained the basis for its protest. A Letter of Findings was issued on August 3, 2006. Believing that the Letter of Findings erred in

certain of its conclusions, taxpayer requested a rehearing on August 26. The request for rehearing was granted and a hearing on the matter was held on November 9. This Supplemental Letter of Findings results.

I. Software Finance Charges – Sales / Use Tax.

DISCUSSION

Taxpayer entered into a financing arrangement in 1997 to purchase computer software and lease certain “hardware items.” Taxpayer points to “options S and T” in a 2000 invoice which – according to taxpayer – represent “financing of one-time charges.” Taxpayer believes the financing charges should be removed “from the audit expense projection.”

Indiana imposes a sales tax on retail transactions and a complimentary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. The Department is unable to agree that the finance charges – which represent one portion of the price taxpayer paid for the software and “hardware items” – can or should be severed from the price it paid for those items. Taxpayer has the burden of demonstrating the Department’s assessment is incorrect. IC § 6-8.1-5-1(b). The basis for taxpayer’s proposition is ambiguous, and the records relevant to original sales/lease transaction are unavailable. Taxpayer’s protest must be denied.

FINDING

Taxpayer’s refund claim – couched as a request to adjust the “audit expense projection” – is respectfully denied.

II. Environmental Quality Control Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer argues that certain items of equipment are not subject to gross retail tax because the items “were associated with wastewater treatment plant” Taxpayer asks for “consistent application of the exemption for all purchases that are part of the wastewater treatment facility and equipment”

Taxpayer includes “documentation from the [municipality] requiring the taxpayer to upgrade its wastewater treatment system because [taxpayer] was out of compliance with the statutes at that time.”

Indiana imposes a sales tax on retail transactions and a complimentary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. The Indiana Administrative Code allows manufacturers an exemption for items which are purchased for the purpose of complying with environmental quality standards. 45 IAC 2.2-5-70. Specifically, the regulation provides as follows:

The state Gross Retail Tax does not apply to sales of tangible personal property which constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominantly used and acquired for the purpose of complying with any state, local or federal environmental quality statutes, regulations or standards; and the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture. 45 IAC 2.2-5-70(a).

Taxpayer has the burden of demonstrating the Department's assessment is incorrect. IC § 6-8.1-5-1(b).

Both the audit review and the original Letter of Findings found that taxpayer was entitled to the exemption on certain items of equipment. Both the audit review and the original Letter of Findings found that taxpayer was not entitled to the exemption for certain other assets.

In particular, the Letter of Findings found that taxpayer had not met its burden of demonstrating that the following items are exempt from sales tax pursuant to 45 IAC 2.2-5-70(a).

- Valves; Asset 21763.
- Wastewater Treatments; Asset 21763.
- Electrical Hookup; Asset 21763.
- Tank; Asset 21763.
- Grate; Asset 21764.
- Noise Reducer; Asset 21832.
- Waste Station Pit; Asset 21832.
- Duskolector Installation; Asset 21832.
- Bag House Upgrade; Asset 21695.

The Department does not dispute taxpayer's argument that it entered into contracts for the acquisition and installation of a variety of pollution control equipment and devices associated with the project. The Department does not dispute taxpayer's contention that it had "supplied documentation of the [taxpayer's] Request for Expenditure . . . for these projects." What the Department must take issue with is taxpayer's conclusion that the Department "indiscriminately selected certain purchases as taxable while allowing other purchases as exempt" In addition, the Department must take exception with taxpayer's assertion that "if needed to make the tax determination [taxpayer] should have been requested during the hearing to prove the expenditure was required for the taxpayer to comply with local statutes for wastewater treatment." It is not for the Department to substantiate taxpayer's protest or to determine what evidence taxpayer should or should not provide.

45 IAC 2.2-5-70 exempts from the Gross Retail Tax "sales of tangible personal property which constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominantly used and acquired for the purpose of complying with any state, local or federal environmental quality statutes, regulations or standards"

Pursuant to 45 IAC 2.2-5-70(a), taxpayer has met its burden of demonstrating that the following items are “incorporated into, or . . . consumed in the operation” of taxpayer’s pollution control facilities.

Valves; Asset 21763.
Wastewater Treatments; Asset 21763.
Tank; Asset 21763.
Grate; Asset 21764.
Waste Station Pit; Asset 21832.
Ph Analyzer; page 54, purchase price \$470.00.

FINDING

To the extent specified herein, taxpayer’s protest is sustained.

III. Production Equipment – Sales / Use Tax.

DISCUSSION

“Transactions involving manufacturing machinery, tools, and equipment are exempt from the state Gross Retail Tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.” IC § 6-2.5-5-3(b).

Taxpayer has met its burden of demonstrating that the following items or transactions are exempt pursuant to IC § 6-2.5-5-3(b).

Tool Holders and Collet Chucks; Asset 21649.
Workstation; page 42, purchase price \$1,450.22.
Rawhide Mallets; page 43, purchase price \$83.88.
Lift Table; page 47, purchase price \$2,516.80.
Engraving Table Workstation; page 47, purchase price \$1,500.
Cutting Spindle; page 49, purchase price \$156.
BiLevel Workstation; page 49, purchase price \$249.95 and \$32.05.
Reversing Starter / Foot Switch; page 54, purchase price \$426.31 and \$112.07.
Photo Switch and Timer; page 55, purchase price \$104.91 and \$188.18.
Roller Lubricator; page 56, purchase price \$269.00.
Tumbler Replacement Part; page 56, purchase price \$144.95.
Hydraulic Hose Cylinders repair parts; page 57, purchase prices \$5.60, \$36.30, \$4.61, \$71.05, \$4.61, \$43.65, \$4.23, \$157.00, \$169.95, \$13.50, \$16.50, \$9.70 and \$140.50.
Boring Bar; page 57, purchase price \$158.00.
Switch; page 58, purchase price \$91.27.
Ultrasonic Replacement Parts; page 61, purchase price \$83.00, \$600, \$8.40, \$278.64 and \$201.56.

Lathe Replacement Parts; page 61, purchase prices \$33.00 and \$21.50.

Taxpayer also asks that the purchase of certain consumable items be exempted from sales tax. Presumably, taxpayer seeks the exemption available pursuant to IC § 6-2.5-5-5.1(b) which states in part as follows:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture.

Taxpayer has met its burden of demonstrating the following items are consumed in the direct production of taxpayer's musical instruments.

Diamond Compound; page 48, purchase price \$72.75 and \$79.50.
Plastic Wedges; page 56, purchase price \$1,288.
Ultrasonic Water; page 61, purchase price \$890.00.
Pipe Cleaners; page 67, purchase prices \$316.00 and \$22.90.
Coolant; page 67, purchase price \$726.00.
Deburring Media; page 67, purchase price \$1,960.00.
Buffing Wheel Cleaner; page 68, purchase prices \$20.32, \$20.32, \$20.32, and \$250.00.
Buffing Wheel Abrasive Compound; page 68, purchase price \$255.00.

FINDING

To the extent specified herein, taxpayer's protest is sustained.

IV. Transporting Work-in-Process – Sales / Use Tax.

DISCUSSION

Equipment used to transport "work-in-process" within the production process is exempt. 45 IAC 2.2-5-8(f)(3). The regulation provides that, "Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process."

According to taxpayer, it constructs music cases at one location and then transports those cases to another location. Taxpayer believes that the music cases are incomplete at the time they are transported because the music cases do "not have labels and do not contain [musical] instruments."

The Department must disagree with the taxpayer's contention that the music cases are "incomplete" and qualify as "work-in-process." 45 IAC 2.2-5-8(f) example EIGHT is instructive. That example states that "A truck . . . is used to transport a finished component part

from the last step of a production process to be introduced into another integrated production process at another business location. The truck is taxable.” Taxpayer constructs music cases to which – at another location – it attaches labels. The music cases do not constitute work-in-process but are “finished component part[s].”

FINDING

Taxpayer’s protest is respectfully denied.

V. Labels and Packing Materials – Sales / Use Tax.

DISCUSSION

Taxpayer argues that certain of its packaging labels are entitled to exempt status under 45 IAC 2.2-5-15 and 45 IAC 2.2-5-16. Departmental regulation states that, “The state Gross Retail Tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling.” 45 IAC 2.2-5-16(a).

Taxpayer argues that it is entitled to an exemption for certain “adhesive product information stickers that are placed on the box prior to the end of production.” Taxpayer is mistaken because the “adhesive product information stickers” are not “enclosures or containers for selling contents to be added”

FINDING

Taxpayer’s protest is respectfully denied.

VI. Water Management Agreement - Sales Use Tax.

DISCUSSION

Taxpayer argues that it should not have been charged sales tax for a “contract to produce a service of inspecting the water used in [taxpayer’s] boiler.”

Taxpayer’s agreement with the contractor specifies that the contractor “agrees to provide services and chemicals and certain equipment incidental to the services as described in the . . . program summary for a period of [one year].” The contractor and taxpayer agreed on a single price for the “services and chemicals and certain equipment” The transaction is governed by 45 IAC 2.2-4-1 which states as follows:

(a) Where ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a “retail merchant.”

(b) All elements of consideration are included in gross retail income subject to tax. Elements of consideration include, but are not limited to:

- (1) The price arrived at between purchaser and seller.
- (2) Any additional bona fide charges added to or included in such price for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other services performed in respect to or labor charges for work done with respect to such property prior to transfer.
- (3) No deduction from gross receipts is permitted for services performed or work done on behalf of the seller prior to the transfer of such property at retail.

The regulation derives from IC § 6-2.5-1-1 which states that a “unitary transaction” includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated.” A “retail unitary transaction” occurs when a retail merchant purchases tangible personal property in his ordinary course of business and then sells that property along with services as a unitary transaction. IC § 6-2.5-1-2.

Because the agreement does not differentiate between the price taxpayer paid for the contractor’s services and price it paid for the chemicals and “certain equipment,” the agreement represents a “unitary transaction” properly subject to sales/use tax.

However, taxpayer also suggests that because the chemicals are used to treat boiler water and that “the boiler and water were previously agreed to as being production equipment supplying steam to various manufacturing processes,” the chemicals are exempt pursuant to IC § 6-2.5-5-3(b). There is nothing to indicate that the chemicals added to the boiler water are acquired for “direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.” The boiler may well be exempt because the boiler is directly used in the direct production of taxpayer’s musical instruments, but the chemicals are not.

FINDING

Taxpayer’s protest is respectfully denied.

VII. Packaging Header Cards – Sales / Use Tax.

DISCUSSION

Taxpayer maintains that its purchases of “header cards” are exempt. As noted above, “The state Gross Retail Tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling.” 45 IAC 2.2-5-16(a).

Taxpayer has provided a photograph of one of the Barger “header cards.” By providing the photograph and demonstrating the manner in which the cards contain one of taxpayer’s products, taxpayer has met its burden of demonstrating that it is entitled to the exemption for these particular purchases.

FINDING

Taxpayer’s protest is sustained.

VIII. Safety Contract – Sales / Use Tax.

DISCUSSION

Taxpayer argues that it is not subject to Sales / Use Tax on the price it paid for a consulting, service contract. A copy of the contract provided by taxpayer stipulates that taxpayer is “engaging the services of [contractor] for the purpose of conducting a safety and regulatory compliance study, including inspection and identification of existing and potential OSHA and applicable state occupation safety and health agency violations.” (Emphasis omitted). There is nothing in the agreement which indicates that taxpayer is purchasing tangible personal property or that the contractor is selling tangible personal property.

However, the contract provided was signed on August 27, 2003, which was a time period outside the audit investigation. Taxpayer has failed to meet its burden pursuant to IC § 6-8.1-5-1(b) of demonstrating that it is entitled to an exemption for contracts entered into during 1999, 2000, 2001, and 2002.

FINDING

Taxpayer’s protest is respectfully denied.

IX. Purchases for Resale – Sales / Use Tax.

DISCUSSION

Taxpayer seeks an exemption on purchases made from certain Indiana vendors on the ground that items purchased were resold. The exemption is set out in IC § 6-2.5-5-8(b) which states as follows:

Transactions involving tangible personal property other than a new motor vehicle are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business without changing the form of the property.

Taxpayer states that certain of the items it purchases are given away and others are “also available for sale.” To establish that a certain number of the purchases are for items it later resold, taxpayer “included a printout showing [taxpayer’s] ‘AV’ number assigned to that product

for inventory purchases.” In addition, taxpayer “included sales invoices for some of these products showing some of these products are for resale.”

The Department does not quarrel with taxpayer’s assertion that when it bought items it later resold to others, those particular purchases are not subject to sales tax. However, the information taxpayer supplied does not permit an accurate determination of which invoices represent purchases of items for resale and which invoices represent purchases of items which were not resold . Taxpayer states that it “previously demonstrated that 21 of the 1,398 dealers are in Indiana and has agreed to a use tax assessment of 1.5 [percent] representing the portion of giveaways remaining in Indiana.” However, the Department is unable to agree that the statement provides a reasoned basis upon which to differentiate exempt invoices from non-exempt invoices. Taxpayer has failed to maintain the records required pursuant to IC § 6-8.1-5-4(a) which states: “Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records.”

FINDING

Taxpayer’s protest is respectfully denied.

DK/JR/BK – December 4, 2006.